

This letter discusses nexus. See *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992). (This is a GIL.)

January 5, 2007

Dear Xxxxx:

This letter is in response to your letter dated August 18, 2006, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

On August 3, 2006, (the 'Company') filed a protective Form BOA-2, Application for Voluntary Disclosure, for retailers' occupation and use taxes with the Department of Revenue. On or about August 11, 2006, the Board of Appeals approved the Application for Voluntary disclosure. This Voluntary Disclosure Application permitted the Company to register to collect tax prospectively on retail sales shipped to customers located in Illinois (sometimes referred to herein as the 'State'). The Company's *future* marketing plans contemplate involvement of employees periodically within the State. The Company, however, believes that its nexus during *prior years* was nebulous, insubstantial, and insufficient to cause it to 'maintain a place of business' in Illinois. We respectfully request that you forward this letter to the appropriate person within the Department of Revenue for a determination on whether substantial nexus existed in prior years. We also request that the Board of Appeals defer action on the Voluntary Disclosure Application (and toll the Company's response deadline) until after the nexus issue has been resolved.

FACTUAL BACKGROUND

The Company is an e-commerce service provider serving thousands of professional photographers throughout the country, including Illinois. The Company generates revenues from several sources. First, the Company offers to store and 'host' its customers' intellectual property (including photo images) electronically on computer systems that the Company maintains outside of the State. Customers can access and

manipulate their intellectual property remotely via the internet. The Company charges a monthly fee for hosting and facilitating the manipulation of the intellectual property. The Company also provides its customers online training, e-mail-based support, and telephone support. Other fees may be charged for converting the intellectual property into an electronic format or providing various other services. The Company's customers may also authorize other parties to log into the Company's computer systems to access the stored information. Many of the Company's customers utilize the Company's hosting services to promote their own photographic business activities.

Second, the Company's customers or their authorized users may direct the Company to utilize the electronically-stored intellectual property to produce photographic prints or various other items of tangible personal property. These customized orders of tangible personal property are placed remotely, primarily over the Internet, and are generally prepaid. The orders for tangible personal property are fulfilled by the Company from facilities located outside Illinois or outsourced to independent contractors located outside the State for fulfillment. Completed orders generally are shipped or drop-shipped to the Illinois customer by common carrier with title passing upon delivery to the shipping carrier. The Customer is paid a royalty each time the intangible property that he or she owns is utilized to fulfill an order placed by a third party.

The Company owns no tangible or real property and maintains no facilities within the State. Likewise, the Company does not utilize employees or independent representatives within the State to contact customers or solicit sales. The Company's direct solicitations are limited to a variety of email marketing techniques designed to apprise potentially interested persons, including persons located in the [sic] Illinois, of the specific content of the hosted intellectual property and its product offerings. However, certain unrelated customers may promote the remote access capability offered by the Company in the marketing information that they distribute to the clients of their independently operated businesses. The Company grants the customers permission to utilize its name, website location, and other related intellectual property for such promotional purposes. Thus, some of the Company's customers are motivated by potential royalties to refer their clients and other interested persons to the Company's website where the 'hosted' intellectual property can be reviewed and orders placed for tangible personal property. For example, a professional photographer hired to shoot pictures of a family gathering may 'host' the photographic images on the Company's computers and direct family members residing throughout the country to order prints via the Company's website. The family member would purchase the prints from the Company and the photographer would receive a royalty for each order.

DISCUSSION

The Illinois use tax is imposed 'upon the privilege of using in this State tangible personal property purchased at retail from a retailer....' 35 ILCS 105/3. The purpose of the use tax is 'primarily to prevent avoidance of the [retailers' occupation] tax by people making out-of-State purchases, and to protect Illinois merchants against such diversion of business to retailers outside Illinois.' *Klein Town Builders, Inc. v. Department of Revenue*, 36 Ill. 2d 301, 303 (1966). While the incidence of the use tax is designed to fall upon the retail consumer, Illinois law effectively deputizes certain out-of-state vendors as collection agents. Specifically, Illinois law states that the use tax 'shall be collected from the [instate] purchaser by a retailer maintaining a place of business in this State....' 35 ILCS 105/3-45. For this purpose, 'a retailer maintaining a place of business in this state' includes 'a retailer having or maintaining within this State, directly

or by a subsidiary, an office, distribution house, sales house, warehouse or other place of business, or any agent or other representative operating within this State under the authority of the retailer or its subsidiary, irrespective of whether such place of business or agent or other representative is located here permanently or temporarily, or whether such retailer or subsidiary is licensed to do business in this State.' 35 ILCS 105/2. In this context, 'operating' has been defined by the Illinois Supreme Court to mean 'to perform work or labor'. *Brown's Furniture, Inc. v. Wagner*, 665 N.E. 2d 795, 800 (Ill. 1996). In addition to satisfying the statutory requirements, a retailer must have more than a 'slight' physical presence in the State. *Id.* at 802; *Quill Corp. v. North Dakota*, 504 U.S. 298, 315 n.8 (1992).

We do not believe that the Company's activities during the prior years constituted 'maintaining a place of business' in Illinois. As stated above, the Company has never maintained a subsidiary, an office, distribution house, sales house, warehouse or other place of business, or tangible or real property within Illinois. Neither has the Company engaged any agent or other representative to operate within Illinois under its authority. Any informal referrals to the Company's website made by the Company's unrelated customers to clients of their independently operated businesses were not made under authority of the Company or on its behalf. The Company did not direct, control or monitor these informal referrals. Indeed, the Company cannot determine whether particular order placed on its website resulted from an electronic solicitation generated by the Company, an informal referral made by the Company's customer, or from another source. Accordingly, we do not believe that the Company 'performed work or labor' in Illinois in prior years. Alternatively, we do not believe that the informal referrals constituted more than a slight physical presence in the State. We respectfully request that the Department of Revenue confirm that, based upon the minimal contacts, if any, described above, the Company was not a retailer maintaining a place of business in this State and was not obligated to collect use tax on retail sales of tangible personal property forwarded to persons within the State by common carrier.

* * *

We appreciate your prompt consideration of this matter. A power of attorney authorizing me to represent the Company with respect to use taxes has been filed with the Board of Appeals.

DEPARTMENT'S RESPONSE

Since you are working with the Board of Appeals, we have copied them on this letter. In the meantime, we hope the following information is helpful.

Determinations regarding nexus are very fact specific and cannot be addressed in the context of a General Information Letter. The Department has found that the best manner to determine nexus is for a Department auditor to examine all relevant facts and information. However, we hope that the following guidelines may be useful to you in determining whether your company would be considered "a retailer maintaining a place of business in Illinois" subject to Use Tax collection obligations.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i). This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. *Quill* at 1910. The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please refer to *Brown's Furniture, Inc. v. Wagner*, 171 Ill.2d 410, (1996).

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax liability on the purchase of the goods and have a duty to self-assess and remit their Use Tax liability directly to the State.

If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Martha P. Mote
Associate Counsel

MPM:msk

Cc: Board of Appeals, Illinois Department of Revenue